

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
I. VARGAS,
dba Madera Connections 2

) OTA Case No. 220911366
) CDTFA Case ID: 02-552-935
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)

OPINION

Representing the Parties:

For Appellant: I. Vargas, Owner

For Respondent: Jason Parker,
Chief of Headquarters Operations

For Office of Tax Appeals: Craig Okihara, Business Taxes Specialist III

N. RALSTON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, I. Vargas (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (respondent)¹ denying appellant's petition for redetermination of a Notice of Determination (NOD) dated January 27, 2021.² The NOD is for tax of \$58,439, plus applicable interest, for the period October 1, 2016, through June 30, 2020 (liability period).³

In preparation for this appeal, respondent performed a reaudit which reduced the taxable measure to \$615,720 and will result in a reduction to the determined tax and applicable interest.

¹ Sales and use taxes were formerly administered by the State Board of Equalization (board). In 2017, functions of the board relevant to this case were transferred to respondent. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, “respondent” shall refer to the board.

² The NOD was timely issued because on October 21, 2020, appellant signed the most recent in a series of waivers of the otherwise applicable three-year statute of limitations for the period October 1, 2016, through September 30, 2017, which allowed respondent until January 31, 2021, to issue an NOD. (R&TC, §§ 6487(a), 6488.)

³ The NOD also reflects a payment or credit of \$11,448.13.

Appellant waived the right to an oral hearing; therefore, the matter was submitted to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(a).

ISSUE

Whether further adjustments to the amount of unreported taxable sales are warranted.⁴

FACTUAL FINDINGS

1. Appellant, a sole proprietor, operated Cricket Wireless retail stores⁵ located in California selling cellular telephones (cellphones), accessories, and wireless service plans.⁶ Appellant offered a lease-to-own option on cellphones that was administered by a third-party leasing company. In addition, appellant received compensation from Cricket Wireless based on his sales volume (commissions).
2. For the liability period, appellant reported on his sales and use tax returns (SUTRs) total sales of \$11,631,770, claiming deductions of \$8,764,759 for nontaxable labor and \$19,857 for sales tax included in reported taxable sales in the fourth quarter of 2019 (4Q19) resulting in reported taxable sales of \$2,847,154.
3. For audit, appellant provided federal income tax returns (FITRs) for 2016, 2017, and 2018; and point of sale (POS) reports for January 1, 2017, through June 30, 2020. Appellant did not provide documentation such as sales tax worksheets and sales tax accrual reports for the liability period. Thus, respondent found the limited books and records provided were incomplete.
4. Respondent compared total sales reported on the SUTRs for 2016,⁷ 2017, and 2018 to the corresponding gross receipts reported on the FITRs noting differences of \$370,839, \$554,207, and \$544,531, respectively. Respondent concluded that the differences

⁴ The audit items at issue are unreported taxable sales of \$291,637 based on differences with Federal Income Tax Returns for the period October 1, 2016, through December 31, 2018, and unreported taxable sales of \$324,085 based on differences with POS sales reports for the period January 1, 2019, through June 21, 2020.

⁵ Over the liability period, appellant concurrently operated at a maximum of ten stores and a minimum of four stores.

⁶ Based on appellant's reported sales, stores were located in Madera County, Fresno County, Sacramento County, Stanislaus County, and Yolo County.

represented unreported total sales. Appellant stated that the entire difference was comprised of nontaxable activation fees⁸ or commissions excluded from the SUTRs but he did not provide documentation to verify the amounts reported as gross receipts. However, based on reported sales on the SUTRs, respondent concluded that it was reasonable that a portion of the difference represented nontaxable sales. Thus, respondent compared total sales reported on the SUTRs for 2016, 2017, and 2018 to claimed deductions and computed a nontaxable sales ratio of 76 percent. Respondent multiplied unreported total sales for each year by the nontaxable sales ratio and computed nontaxable sales of \$280,067 for 2016, \$418,552 for 2017, and \$411,244 for 2018. Respondent deducted nontaxable sales from the total sales difference and calculated unreported taxable sales of \$90,772 for 2016, \$135,655 for 2017, and \$133,287 for 2018. For the period October 1, 2016, through December 31, 2018, respondent computed unreported taxable sales of \$291,635 $((\$90,772 \div 4 \text{ quarters}) + \$135,655 + \$133,287)$.⁹ (Audit item 1.)

5. Using the POS reports, respondent compiled recorded sales of cellphones and accessories of \$3,897,245 for the liability period.¹⁰ Appellant stated that customers have the option to select a payment plan offered by a third-party leasing company for the purchase of the cellphone. Appellant stated he collected the initial payment, and the customer would make the remaining payments to the leasing company who collected and reported the sales tax. Respondent reviewed leasing receipts and agreements and concluded the amounts appellant pays to the leasing company as a “vendor rebate” represent reductions to recorded sales of cellphones. Respondent compiled \$625,187 for payments to the leasing company which were deducted from recorded cellphone and accessory sales to compute audited taxable sales of \$3,272,058 for the liability period.
6. Upon comparison to reported taxable sales, respondent computed differences of \$424,904 $(\$3,272,058 - \$2,847,154)$ for the liability period. Respondent noted credit differences

⁸ Appellant charged customers a one-time fee for activating a cellphone for use on the Cricket Wireless network.

⁹ The reaudit report shows a taxable measure of \$291,637 for this item.

¹⁰ For periods where appellant did not provide a POS report, respondent used the average quarterly sales computed from the available POS reports for the location.

(reported taxable sales exceeded recorded taxable sales) in each quarter during the period April 1, 2017, through September 30, 2018, but because respondent's analysis of appellant's FITRs had established unreported taxable sales covering the period October 1, 2016, through December 31, 2018, respondent decided to offset the credit amounts to other periods with unreported taxable sales (October 1, 2016, through March 31, 2017, and October 1, 2018, through March 31, 2019). This resulted in redistributing the difference (unreported taxable sales) of \$424,904 to only the period January 1, 2019, through June 30, 2020. (Audit item 2.)

7. Respondent issued an NOD to appellant on January 27, 2021, based on the above-mentioned audit, with a tax liability of \$58,439 plus applicable interest.
8. Appellant filed a timely petition for redetermination disputing the NOD in its entirety.
9. Respondent held an appeals conference with appellant, and subsequently issued a decision on August 24, 2022, denying the petition.
10. Appellant timely appealed to OTA.
11. In respondent's review of the audit, respondent noted appellant's payment of tax for the 4Q19 exceeded the calculated amount due by \$9,380 but had not been addressed in the audit. Respondent believed appellant erred and overstated the deductions claimed but paid the tax based on recorded taxable sales. Thus, respondent computed the measure of \$113,697 by dividing the excess tax by the sales tax rate of 8.25 percent in effect for Madera County (county with the majority of sales). Respondent adjusted the 4Q19 recorded taxable sales to \$114,537 (\$228,234 - \$113,697) which reduced recorded taxable sales to \$3,158,361 for the liability period.
12. Upon comparison to reported taxable sales, respondent computed differences of \$311,207 (\$3,158,361 - \$2,847,154) for the liability period. Respondent offset the credit amounts from April 1, 2017, through September 30, 2018, to October 1, 2016, through March 31, 2017, and October 1, 2018, through March 31, 2019. Respondent believed the \$12,878 credit for 4Q19 was due to differences in the calculation for district taxes and did not represent that reported taxable sales were overstated. Respondent concluded that the correct tax was paid; therefore, respondent accepted taxable sales as reported for 4Q19. This resulted in unreported taxable sales of \$324,085 (\$311,207 + \$12,878) for the period January 1, 2019, through June 30, 2020. (Audit item 2.)

13. Respondent prepared a reaudit report dated November 28, 2022, which reduced the taxable measure by \$100,819 from \$716,539 to \$615,720 (\$291,635 + \$324,085), which remains in dispute.

DISCUSSION

Issue: Whether further adjustments to the amount of unreported taxable sales are warranted.

California imposes sales tax on a retailer's retail sales of tangible personal property sold in this state measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

Generally, tax applies to the gross receipts from the retail sale of a wireless telecommunication device. (Cal. Code Regs., tit. 18, § 1585(b)(1).) Gross receipts are the total amount of the sale price and include: any services that are part of the sale; all receipts, cash, credits and property of any kind; and any amount for which credit is allowed by the seller to the purchaser. (R&TC, § 6012(b)(1)-(3).) Under certain conditions, payments received by the retailer in the form of rebates or other types of payments for products sold at retail are included in the retailer's gross receipts or sales price from the sale of the product. (Cal. Code Regs., tit. 18, § 1671.1(a).) It is rebuttably presumed that any consideration received by retailers from third parties related to promotions for the sale of specified products is subject to tax until the contrary is established. (Cal. Code Regs., tit. 18, § 1671.1(c)(3)(A).)

If respondent is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, respondent may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish

that a result differing from respondent's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, appellant did not provide complete books and records for audit. It is the retailer's responsibility to maintain and make available for examination on request all records necessary to determine the correct tax liability, including bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Respondent's analysis of the limited books and records found that both gross receipts reported on the FITRs and taxable sales recorded in appellant's POS reports exceeded the corresponding sales reported on the SUTRs. Appellant did not provide documentation to support that the differences were related to nontaxable sales. Therefore, respondent was justified in rejecting reported taxable sales and relying upon appellant's FITRs and POS reports as the basis for respondent's determination. Thus, respondent has met its initial burden to show that its determination was reasonable and rational. Therefore, the burden of proof shifts to appellant to show errors in the audit.

Appellant contends that the differences represent commissions received which are not subject to sales tax.

For the period January 1, 2019, through June 30, 2020, respondent established recorded taxable sales of cellphones and accessories from appellant's POS reports. Thus, OTA expects that the entire difference for this period would represent only sales appellant had recorded as taxable but failed to report on his SUTRs. Appellant has not provided verifiable documentation warranting adjustment to unreported taxable sales for nontaxable commissions included in recorded taxable sales.

For the period October 1, 2016, through December 31, 2018, respondent identified differences between gross receipts appellant reported on his FITRs and total sales reported on his SUTRs. Respondent allowed 76 percent of the difference as nontaxable sales based on the ratio of taxable and nontaxable sales appellant reported on his SUTRs. Appellant has not provided verifiable documentation to support the amount of commissions received and reported in gross receipts, or that nontaxable commissions were more than 76 percent of the difference.

Accordingly, for the above reasons, OTA finds no basis to recommend adjustment to unreported taxable sales for appellant's argument that the audit differences represent nontaxable commissions.

In summary, respondent computed audited taxable sales based on the best-available evidence. Appellant has not identified any errors in respondent’s computation of audited taxable sales or provided documentation or other evidence to support that his FITRs or POS reports are inaccurate or are otherwise unreliable. As appellant bears the burden of proof in this case, no further adjustments to unreported taxable sales are warranted.

HOLDING

Appellant has not shown that further adjustments to the amount of unreported taxable sales are warranted.

DISPOSITION

Respondent’s action in reducing the determined measure of tax by \$100,820 from \$716,539 to \$615,720 but otherwise denying the petition is sustained.

DocuSigned by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

We concur:

DocuSigned by:
Andrew J. Kwee
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Andrew J. Kwee
Administrative Law Judge

DocuSigned by:
Josh Lambert
CB1F7DA37831416...
Josh Lambert
Administrative Law Judge

Date Issued: 8/25/2023